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No. 88-1603

IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

NORTHERN PROPANE GAS COMPANY,
Petitioner,

v.

H. FLOYD MCGAHEE,
Respondent.

On Appeal from the United States Court of Appeals for the Eleventh Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI AND BRIEF OF THE BUSINESS ROUNDTABLE AS AMICUS CURIAE

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The Business Roundtable respectfully moves for leave to file the attached brief as amicus curiae in this case. The consent of the attorney for petitioners has been obtained, but the attorney for respondent has refused to consent.

The Business Roundtable is an association of about 200 member companies represented by their chief executive officers. These substantial companies are widely dispersed by type of business and geographic location. The companies represented in The Business Roundtable are substantial producers and consumers of goods and services who believe it is critical that the marketplace operate

competitively. They are, therefore, vitally interested in interpretations of the antitrust laws that adversely affect competition.

This case involves the appropriate measure of cost and standard of proof in predatory pricing cases. Because predatory pricing claims are usually directed against firms with substantial market shares, the issues presented in this case are obviously of particular importance to large business organizations like those represented in The Business Roundtable. But those issues are also critical for a broad segment of the business community because even a relatively small company can have a significant share of sales in small markets like the one at issue here.

The brief The Business Roundtable requests permission to file describes the practical implications of the decision of the United States Court of Appeals for the Eleventh Circuit. As discussed in the attached brief, the standard established by the Eleventh Circuit decision will be virtually impossible for businesses to apply. The decision will have anticompetitive effects because it will deter businesses from engaging in vigorous price competition.

For the foregoing reasons, The Business Roundtable requests that the attached brief in support of the petition for a writ of certiorari be accepted for filing.

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BRIEF FOR THE BUSINESS ROUNDTABLE AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF AMICUS CURIAE AND SUMMARY OF ARGUMENT

The Business Roundtable is an association of about 200 member companies represented by their chief executive officers. These substantial companies are widely dispersed by type of business and geographic location. The companies represented in The Business Roundtable are substantial producers and consumers of goods and services who believe it is critical that the marketplace operate competitively. They are, therefore, vitally interested in interpretations of the antitrust laws that adversely affect competition.

This case squarely presents issues that this Court has discussed, but never decided—the appropriate measure of cost and standard of proof in predatory pricing cases.[1] The opinion of the United States Court of Appeals for the Eleventh Circuit deviates from the standard adopted by most of the other Circuits that have considered these questions. The opinion establishes a standard that will make it impossible for businesses to engage safely in vigorous price competition. It will also encourage baseless antitrust litigation by competitors who are inconvenienced by hard competition and prevent courts from resolving predatory pricing cases without trial.

Because predatory pricing claims are usually directed against firms with substantial market shares, the issues presented in this case are obviously of particular importance to large business organizations like those represented in The Business Roundtable. But these issues are also critical for a broad segment of the business community because even a relatively small company can have a significant share of sales in small markets like the one at issue here.

I. THE ELEVENTH CIRCUIT'S RULING WILL HAVE A CHILLING EFFECT ON VIGOROUS PRICE COMPETITION.

Predatory pricing is generally understood to mean a firm's efforts to eliminate existing rivals or exclude potential rivals through low prices. But because one of the goals of the antitrust laws is to insure that consumers pay low prices, it is imperative to distinguish between

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[1] In *Cargill, Inc. v. Montfort of Colorado, Inc.*, this Court wrote, "in this case, as in *Matsushita Electrical Industrial Co. v. Zenith Radio Corp.*, we find it unnecessary to 'consider whether recovery should *ever* be available . . . when the pricing in question is above some measure of incremental cost,' . . . or whether above-cost pricing coupled with predatory intent is ever sufficient to state a claim of predation." 479 U.S. 104, 117-18 n.12 (1986) (emphasis in original; citation omitted).

anticompetitive pricing behavior and desirable price competition. This Court has recognized the importance of vigorous price competition, and noted that unfounded claims of price predation present a serious threat to competition. In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, for example, the Court stated:

> [C]utting prices in order to increase business often is the very essence of competition. Thus, mistaken inferences in cases such as this one are especially costly, because they chill the very conduct the antitrust laws are designed to protect. [475 U.S. 574, 594 (1986)].

Similarly, in *Cargill, Inc. v. Montfort of Colorado, Inc.*, this Court wrote:

> [C]ompetition for increased market share [by lowering prices to slightly above costs] is not activity forbidden by the antitrust laws. It is simply . . . vigorous competition. To hold that the antitrust laws protect competitors from the loss of profits due to such price competition would, in effect, render illegal any decision by a firm to cut prices in order to increase market share. The antitrust laws require no such perverse result, for "[i]t is in the interest of competition to permit dominant firms to engage in vigorous competition, including price competition." [479 U.S. at 116 (citation omitted)].

This brief will first explain the practical implications of the Eleventh Circuit decision and why it will seriously inhibit pro-competitive behavior.

A. Businesses Require a Clear and Objective Standard Governing Predatory Intent.

The competitive marketplace forces fast pricing decisions. A business that faces an imminent assault on its market position by an existing competitor, or a competitor about to enter the market, must react quickly. Obviously, a price cut is one strategy that needs to be considered, and even companies with very high market shares

are legally permitted to cut prices in response to competition. *See, e.g., MCI Communications Corp. v. American Tel. & Tel. Co.*, 708 F.2d 1081, 1114 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983); *Telex Corp. v. International Business Machines Corp.*, 510 F.2d 894 (10th Cir.), *cert. dismissed*, 423 U.S. 802 (1975). A company needs to be reasonably certain, however, not only that competitive pricing decisions are unlikely to result in antitrust liability, but also that they are unlikely to result in baseless, but expensive and protracted, treble-damage litigation.

Commentators and courts have generally recognized that a relatively clear, comprehensible standard is needed for several reasons.[2] In the absence of such a standard, businesses cannot be certain their pricing decisions are legal and legitimate price competition will be chilled. In addition, the absence of such a standard can encourage baseless litigation by less efficient competitors who want protection from vigorous competition. Finally, the absence of such a standard will inevitably complicate and prolong litigation because courts will be unable to dispose of predatory pricing claims without trial.

There is a widespread understanding of the burdens on public and private resources that are imposed by prolonged court proceedings, but it is also important to consider the burdens that are imposed when unduly exhaustive internal inquiries are necessary before a company can determine that a given competitive strategy is lawful. A business needs to have some guidelines, however rough cut, that will provide a safe harbor from antitrust litiga-

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[2] The cases that consider the need for an objective standard are discussed below. Many commentators also recognize the need for an objective test of predatory pricing. *See, e.g.*, III P. AREEDA & D. TURNER, ANTITRUST LAW ¶¶ 711-14 (1978); R. GIVENS, ANTITRUST: AN ECONOMIC APPROACH § 3.04 (1988); R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 184-96 (1976); Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 Yale L.J. 213 (1979).

tion, at least in all but the most extraordinary cases. If there are no guidelines that can be readily understood and quickly applied, a business may have to undertake complicated market studies and extensive file searches before it can begin to evaluate its legal position. Even if it takes such steps, it may have little confidence in the outcome. Price competition will ultimately be chilled and consumers will suffer.

As petitioners point out,[3] a majority of circuits have endorsed some form of the so-called "Areeda-Turner" test, which presumes that prices above short run marginal cost cannot be predatory.[4] Because corporate accounting data do not readily permit a determination of marginal cost, the Areeda-Turner test permits the use of short run average variable cost as a surrogate for marginal cost. The Areeda-Turner test has been widely accepted and has provided the rough guide that business people need for over a decade.

A large number of learned articles have explored the precise contours of the test and suggested variations that might yield more precise results in hypothetical cases.[5]

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[3] Petition for a Writ of Certiorari at 12-13.

[4] The test was first articulated in Areeda & Turner, *Predatory Pricing and Related Practices Under Section 2 of the Sherman Act*, 88 Harv. L. Rev. 697 (1975). It was further explained and slightly modified in III P. AREEDA & D. TURNER, ANTITRUST LAW ¶¶ 711-22 (1978) and P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶¶ 710-21 (1988 Supp.).

[5] *See, e.g.*, R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 184-96 (1976); Baumol, *Quasi-Permanence of Price Reductions: A Policy for Prevention of Predatory Pricing*, 89 Yale L.J. 1 (1979); Hay, *The Economics of Predatory Pricing*, 51 Antitrust L.J. 361 (1982); Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 Yale L.J. 213 (1979); Scherer, *Predatory Pricing and the Sherman Act*, 89 Harv. L. Rev. 869 (1976); Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 Yale L.J. 284 (1977).

However, judges and business people seem to appreciate that ease of application is more important than absolute precision.

The Areeda-Turner test can be applied in a practical way by businesses and their legal advisors. The basic question is whether sales at the price in question will make an immediate positive contribution to bottomline results or whether they will reduce profits. Precise calculations usually are not necessary because business people are apt to have a fairly good intuitive feeling about the answer to this basic question, and they can allow a margin of error for the sake of safety in litigation. If the sales in issue will make a contribution to profits, there is no need to look further; if they will not be profitable, then a further inquiry into motivation and likely consequences of a price cut may be required.

B. Other Circuits Have Adopted a Clear and Objective Standard.

Most recent court decisions concerning predatory pricing recognize the practical realities of business decision-making and have developed a practical standard that is relatively easy for businesses and courts to apply. For example, in its recent decision in *Barry Wright Corp. v. ITT Grinnell Corp.*, the First Circuit concluded that it would rely on the Areeda-Turner test as a basis for distinguishing predatory price cutting from legitimate competition. 724 F.2d 227, 231-36 (1st Cir. 1983). Judge Breyer wrote for the majority:

> [O]ne must ask why the Sherman Act *ever* forbids price cutting. After all, lower prices help consumers. The competitive marketplace that the antitrust laws encourage and protect is characterized by firms willing and able to cut prices in order to take customers from their rivals. * * * Thus, a legal precedent or rule of law that prevents a firm from unilaterally cutting its prices risks interference with one of the Sherman Act's most basic objectives: the low price

> levels that one would find in well-functioning competitive markets. * * * [T]he antitrust courts' major task is to set rules and precedents that can segregate the economically harmful price-cutting goats from the more ordinary price-cutting sheep, in a manner precise enough to avoid discouraging desirable price-cutting activity. [*Id.* at 231-32 (emphasis in original; citations omitted)].

Similarly, the Second Circuit has concluded that prices below reasonably anticipated marginal costs will be presumed predatory, while prices above reasonably anticipated marginal costs will be presumed non-predatory. *Northeastern Tel. Co. v. American Tel & Tel. Co.*, 651 F.2d 76, 88 (2d Cir. 1981), *cert. denied*, 455 U.S. 943 (1982). The Second Circuit articulated the rationale for its adoption of the Areeda-Turner test as follows:

> [W]e must be mindful both of the limits of the judicial process and the realities of the marketplace. Court occasionally err in applying even the clearest legal rules. The more complicated that standard, the greater the chance for misapplication. * * * Predatory pricing is difficult to distinguish from vigorous price competition. Inadvertently condemning such competition as an instance of predation will undoubtedly chill the very behavior the antitrust laws seek to promote. [*Id.* at 88].

Accord, *Henry v. Chloride, Inc.*, 809 F.2d 1334, 1346 (8th Cir. 1987).

Other courts have adopted some variant of the Areeda-Turner test that provides reasonably concrete guidance to both lower courts and businesses. For example, the Seventh Circuit has held that predatory pricing must be based on proof of pricing below cost:

> There is . . . . no reliable way to determine whether predatory pricing has occurred without some comparison between the prices charged and a properly defined measure of the cost of production. * * * In

> the absence of an objective standard, firms making pricing decisions in the presence of competition would be unable to ascertain what price reductions may be lawfully undertaken. [*MCI Communications Corp. v. American Tel. & Tel. Co.*, 708 F.2d at 1112-13].

The Fifth Circuit has also adopted an objective approach and held that prices above short run average variable cost are presumptively lawful, unless there are substantial entry barriers. *Adjusters Replace-A-Car, Inc. v. Agency Rent-A-Car, Inc.*, 735 F.2d 884, 889-91 (5th Cir. 1984), *cert. denied*, 469 U.S. 1160 (1985); *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d 714, 724 (5th Cir. 1975), *cert. denied*, 424 U.S. 943 (1976).

The test in the Eleventh Circuit opinion, by contrast, provides no help at all.[6] The opinion below states that a jury question on predatory intent is presented whenever prices dip below "the average of the total economic cost, which includes the necessary minimum profit," and further notes that "[t]he amount of profit that is a part of total economic cost is an issue of fact requiring expert testimony particular to the market involved."[7] *Any* price response to competition would raise a potential jury issue under this test since experts may differ about the appropriate level of profit in an industry.

It is hard to imagine a test that would be more difficult for businesses to apply or that would more greatly inhibit price competition. A company with a large market share would have to maintain its traditional profit margins in the face of an intense price assault or risk

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[6] A recent decision by the Federal Circuit raises similar problems. In *U.S. Philips Corp. v. Windmere Corp.*, 861 F.2d 695 (Fed. Cir. 1988), the Federal Circuit reversed the entry of summary judgment for defendant, largely because of subjective evidence of predatory intent.

[7] Appendix A to Petition for a Writ of Certiorari at 18a & n.35.

treble antitrust damages. In fact, as Petitioners point out, this test would force a company to *raise* its prices as competitive pressures cause its volume to decline.[8] This is simply absurd.

II. THE ELEVENTH CIRCUIT SHOULD NOT HAVE RELIED ON AMBIGUOUS EVIDENCE OF PREDATORY INTENT.

Another critical flaw in the Eleventh Circuit's opinion is its reliance on subjective evidence of the defendant's intent to harm competitors by cutting prices. The Eleventh Circuit held that if prices were below average total cost (plus profit), but above short run marginal cost, the plaintiff could demonstrate predatory intent by introducing other evidence, such as documents from the defendant's files showing a desire to harm a rival.[9] Every vigorous competitor intends to harm its rivals, however, and competition stagnates when firms try to avoid doing so.

Most commentators and other courts that have considered predatory pricing claims have recognized that subjective evidence of intent is virtually useless and should not form a basis for any judicial decision. In his treatise on antitrust law, Judge Posner aptly described the problems with such evidence:

> [T]he availability of evidence of improper intent is often a function of luck and of the defendant's legal sophistication, not of the underlying reality. A firm with executives sensitized to antitrust problems will not leave any documentary trail of improper intent; one whose executives lack this sensitivity will often create rich evidence of such intent simply by the clumsy choice of words to describe innocent behavior. Especially misleading here is the inveterate tendency of sales executives to brag to their superiors about their competitive prowess, often using metaphors of

[8] Petition for a Writ of Certiorari at 21-22.

[9] Appendix A to Petition for a Writ of Certiorari at 18a.

> coercion that are compelling evidence of predatory intent to the naive. Any doctrine that relies upon proof of intent is going to be applied erratically at best. [R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 189-90 (1976)].

The objective tests for predatory pricing utilized by most courts recognize this problem. Those tests also recognize that unless the defendant's price is below some appropriate measure of cost, subjective evidence of intent should be irrelevant because low prices cannot have any anticompetitive effect. *See, e.g., Henry v. Chloride, Inc.*, 809 F.2d at 1344; *Barry Wright Corp. v. ITT Grinnell Corp.*, 724 F.2d at 232; *MCI Communications Corp. v. American Tel & Tel. Co.*, 708 F.2d at 1112; *William Inglis & Sons Baking Co. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1028 (9th Cir. 1981), *cert. denied*, 459 U.S. 829 (1982).

The evidence relied on by the Eleventh Circuit vividly illustrates this problem. The court based its finding of predatory intent on evidence that the defendant had investigated the plaintiff's financial condition, provided free propane tanks to customers, and prepared documents that discussed "contribut[ing] to [the plaintiff's] financial problems." [10] This kind of evidence is totally ambiguous; it could just as easily indicate vigorous competition. But in any event, unless the defendant's pricing practices were anticompetitive by some objective standard, evidence of saber rattling rhetoric is meaningless.

The Eleventh Circuit's reliance on ambiguous evidence of subjective intent, if sustained, would further complicate the inquiry corporate counsel must make to advise on the legality of a proposed price cut. Competitive action in the marketplace usually cannot await a lengthy file search to make sure that no rhetorical excesses have been memoralized somewhere in the company's records.

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[10] Appendix A to Petition for a Writ of Certiorari at 20a.

III. THE ELEVENTH CIRCUIT MISAPPLIED THE REQUIREMENT OF A "DANGEROUS PROBABILITY OF SUCCESS".

In addition to the assurance provided by an objective cost/price test, companies that want to compete on price also gain needed assurance from the requirement that a plaintiff must prove a dangerous probability of monopoly power arising from the price cuts in issue. This means more than the prospect of inconvenience or financial injury to the plaintiff; it means a realistic chance that the defendant will emerge from a price war with a market position secure enough to recoup its losses through supracompetitive prices.

This Court and many lower courts have recognized that entry barriers should be critical to a predatory pricing case. Predatory pricing is rational business behavior only if the predator can recoup the losses sustained by charging monopoly prices after its rivals are eliminated. However, it can do so only if its monopoly prices do not attract new entry. Thus, losses incurred through predatory pricing can be recouped only if there are substantial barriers to entry. Unless such barriers exist, firms are unlikely to engage in predatory pricing because there will be no reasonable prospect of recovering the losses sustained when prices were low.

In *Matsushita*, this Court wrote, "without barriers to entry it would presumably be impossible to maintain supracompetitive prices for an extended time." 475 U.S. at 591. In *Cargill*, the Court explained this idea at greater length:

> In evaluating entry barriers in the context of a predatory-pricing claim, however, a court should focus on whether significant entry barriers would exist *after* the merged firm had eliminated some of its rivals, because at that point the remaining firms would begin to charge supracomptitive prices, and

> the barriers that existed during competitve conditions might well prove insignificant. [479 U.S. at 120 n.15].

Accord, e.g., Adjusters Replace-A-Car, Inc. v. Agency Rent-A-Car, Inc., 735 F.2d at 889-91; *Northeastern Tel. Co. v. American Tel. & Tel. Co.*, 651 F.2d at 89; *International Air Indus., Inc. v. American Excelsior Co.*, 517 F.2d at 724.[11]

The District Court opinion below recognized the importance of entry barriers in this case.[12] The District Court undertook a detailed analysis of barriers to entry in the market and concluded that entry was relatively easy. Indeed, the plaintiff's own success provided a powerful example of ease of entry. The plaintiff was able to enter from scratch with $800,000 of borrowed capital and capture a substantial share of the market, despite the defendant's efforts to compete on price. As a result of the plaintiff's new entry and price competition, the defendant's market share fell from 65 percent in 1981 to 35 percent in 1983.[13] There is no realistic risk that this defendant could ever exercise monopoly power and maintain its market position with supracompetitive prices when it could not even maintain its market position in the midst of a price war.

The Eleventh Circuit ignored these facts and held that there was sufficient evidence of a dangerous probability of monopolization simply because at the time the plaintiff

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[11] Most commentators agree that entry barriers are critical. *See, e.g.*, III P. AREEDA & D. TURNER, ANTITRUST LAW ¶ 711b at 151-52; P. AREEDA & H. HOVENKAMP, ANTITRUST LAW ¶ 711.2d at 498-99 (1988 Supp.); Hay, *The Economics of Predatory Pricing*, 51 Antitrust L.J. 361, 364 (1982); Joskow & Klevorick, *A Framework for Analyzing Predatory Pricing Policy*, 89 Yale L.J. 213, 227-34, 245-49 (1979).

[12] Appendix B to Petition for a Writ of Certiorari at 32a-33a.

[13] Appendix A to Petition for a Writ of Certiorari at 22a n.45.

entered the market, the defendant had a 65 percent market share.[14] The defendant, having apparently been battered by the plaintiff in a price war, now faces the prospect of paying treble damages to the victor—all based on highly ambiguous evidence of "predatory" intent. A decision of this kind, if allowed to stand, cannot help but dampen enthusiasm for price competition by other companies in the future.

CONCLUSION

The widespread adoption of simplified rules like the Areeda-Turner test reflect a growing recognition that rules of presumptive *legality* can be just as important as rules of presumptive or *per se illegality*. *Per se* rules are important not only to expedite litigation, but also to expedite business decisions and thereby improve the operation of our competitive system. The *per se* rule against price fixing by competitors, for example, not only reduces the burden of litigation, but also makes it easier for businesses to predict the outcome of litigation and to adjust their conduct accordingly. Presumptions of legality—particularly the legality of price competition—can serve the same useful purpose. Price competition should be encouraged, not discouraged, and firms are much more likely to compete on price if they have realistic guidelines and are able to make a prompt determination that a proposed price cut will, for all practical purposes, be presumptively legal.

The decision of the Eleventh Circuit provides no useful guidelines for legal price competition. It ignores the strong policy directions of this Court and the practical standards endorsed by virtually every other court that has considered the issue. The Business Roundtable, as *amicus curiae*, urges this Court to review the Eleventh

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[14] *Id.* at 21a-22a.

Circuit decision and take this opportunity to endorse a realistic and objective standard for decision in predatory pricing cases.

Respectfully submitted,

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